



Possible Peak Rises in Headline Inflation

In March, CPI increased by 1.08%, in line with the median expectation of 1.04% increase

Turkey's inflation rose slightly more than expected to 1.08% in MoM March. The median estimate was stood at 1.04%, with forecasts ranging between 0.83% and 1.75%. Turkey posted a 0.57% monthly rise in consumer prices in March 2020. In addition, the historical average of the 2003-based index for March is at the level of 0.73% rise. These figures indicate that the base effect is slightly adverse for this month.

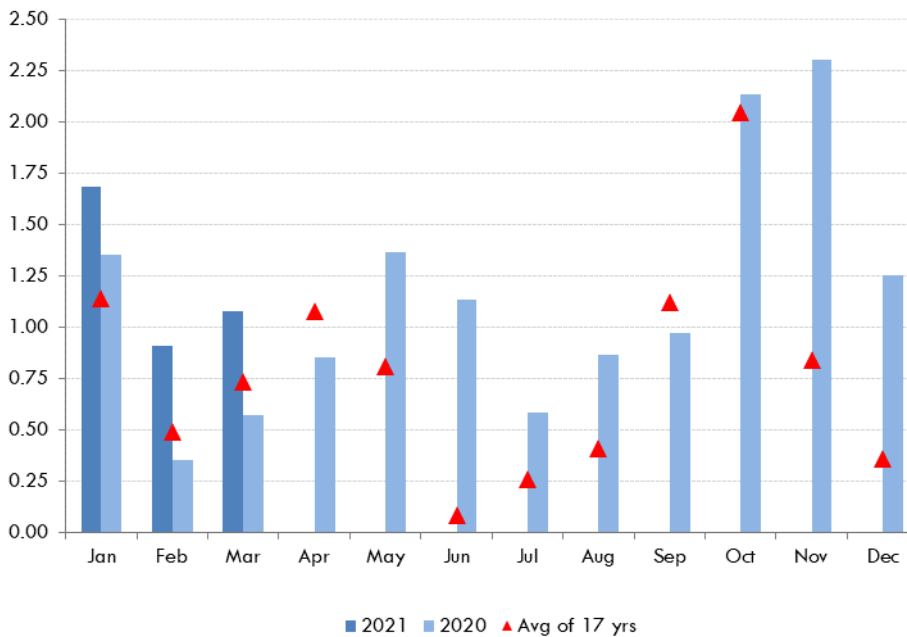
The main drivers of March's CPI increase was the price rises in non-food groups. Food prices rose 1.13%, less than 1.95% a year earlier. Monthly hikes in education, health, hotel-cafes-restaurants, recreation-culture were the main drivers of March inflation. Also the rise in clothing prices more than the seasonal trend pulled inflation up significantly. Nevertheless, price increases in groups sensitive to the exchange rate (furniture, home textile, home appliances, audio-visual systems, personal care products, etc.) increased moderately except for medical products. In March, an increase of 0.09% was observed in the energy group which is above last year. Thus, Turkey's annual inflation surged more than expected to 16.19% last month after rising 15.61% in February.

The unprocessed food prices dragged down the food inflation

Unprocessed food prices rose by 1.3% in March, compared with a surge of 3.1% a year earlier. Hence, the annual unprocessed food inflation fell from 17% to 15%, whereas the annual inflation in processed food prices rose up to 19.9%. Although the annual rate of increase in food prices fell to 17.4%, this rate is still far above the historical average of food prices (10%) and the CBRT's Inflation Report food price assumption (11.5%). Therefore, food prices will be one of the main drivers of deviating from the CBRT's end-2021 inflation forecast. (9.4%)

Peak in headline inflation could be in the range of 18-19%, the rest depends on the exchange rate and domestic demand

The annual CPI, which stood at 16.19% rising 0.58 points in March compared to the previous month, posted above the uncertainty band around the inflation target (5%) and CBRT's end-2021 forecast (9.4%).



Other than the volatility of food prices, the outlook of exchange rate movements, public price/tax adjustments, prices of crude oil and other commodities will determine the direction of risks on inflation in the upcoming period. In the short term, the undesirable effects of the global food, oil and commodity prices upsurge continue. Moreover, exchange rate volatility and developments in import prices continue to adversely affect the course of inflation. In addition, the economic activity closing the first quarter without being much affected by the monetary tightening and the minimum wage increase, which is well above the inflation target, keep the risks on inflation outlook upside. Therefore, even if the depreciation of the TL does not deepen, the peak in inflation can be reached in the range of 18-19% in April or May. Then, with a gradual decline, inflation may decline to the range of 13-14% at the end of the year. The recent surveys predicted the end-2021 inflation is expected to reach 12.5%

March 2021

		Monthly(%)	Annual(%)
1. Special CPI indicators			
A	CPI excluding seasonal products	1.08	17.22
B	CPI excluding unprocessed food, energy, spirits, tobacco and gold	1.26	17.49
C	CPI excluding energy, food and non-alcoholic beverages, alcoholic beverages and tobacco products and gold	1.33	16.88
D	CPI excluding unprocessed food, alcoholic beverages and tobacco products	1.10	17.28
E	CPI excluding alcoholic beverages and tobacco	1.13	17.00
F	CPI excluding administered prices	1.12	17.82
2. Goods			
	Energy	0.09	12.43
	Food and soft drinks	1.13	17.44
	Unprocessed food	1.32	14.98
	Fresh fruit and vegetables	0.34	7.04
	Other unprocessed food	1.87	19.96
	Processed food	0.95	19.87
	Bread and cereals	1.20	19.67
	Other processed food	0.82	19.92
	Energy and non-food goods	1.24	19.74
	Essential goods	1.39	22.14
	Clothing and shoes	1.74	7.33
	Durable goods (except Gold)	0.35	33.29
	Other essential goods	2.84	16.80
	Alcoholic beverages, tobacco, and gold	0.42	10.95
3. Services			
	Rent	0.57	9.24
	Restaurants and hotels	2.60	15.39
	Transport services	0.27	9.96
	Communication services	1.32	7.36
	Other services	1.05	14.69

Core inflation (B and C Index), the better measure of underlying trend, stood at 17.5% and 16.9%, rising 0.6 and 0.7 points, respectively, while the annual increase in service prices reached 12.6%

Core annual inflation peaked at 24.4% in October 2018 with the acceleration of exchange rate increases after March 2018. Yet, this figure later receded to 7.6% in October 2019, by cause of the significant appreciation in TL.

In the following period, the upward trend continues with the lagged effect of exchange rate increases. In addition, the fact that the producer price increase reached 31.2% annually reflects that the cost pressures continue to get stronger. Durable goods prices swelled 0.35% MoM, while core goods inflation rose up to 22.1%, on an annual basis in March. On the other hand, services inflation, which was affected more limitedly by exchange rates, increased significantly. Among the subgroups, rental and transportation services increased slightly, while the annual inflation of restaurants-hotels, communication and other services groups increased significantly.

CBRT skip the April meeting, the Inflation Report at the end of the month may give more clues for the following period

Former CBRT Governor Agbal raised the one-week repo rate by 200 bps to 19% at the March MPC meeting, while reiterating the message that the tight monetary policy stance will be maintained for a long time and additional tightening can be made if necessary until a permanent decline in inflation is achieved. Yet Turkey's surprise decision to fire Agbal has jumped uncertainty and inflamed concerns about return to unorthodox policies. After all, Turkey faced sharp portfolio outflows and the Turkish Lira crashed. The new Governor, Mr. Kavcioglu emphasizes the continuity in policies since the day he took office and gives the message that "until strong indicators that point to a permanent decline in consumer prices are formed, the policy rate will continue to keep its benchmark policy rate above inflation."

As a result, we are of the opinion that the CBRT will most likely not change the policy rate at the following MPC meeting. As well, the CBRT forecasts for the inflation path in the Inflation Report, which will be announced on April 29, will enable us to obtain more clues regarding the monetary policy to be implemented in the upcoming period.

Contact information

BÜRÜMCEKÇİ RESEARCH & CONSULTANCY

www.burumcekci.com

Phone: +90 533 644 36 02

E-mail: haluk@burumcekci.com

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